

Animal Spirits Meet Quotas and Tariffs: India-US Trade Deal Explained



Deepanshu Mohan and Ankur Singh

09/Feb/2026

Fixed tariffs, quotas and mandated purchases in the India-US trade agreement mark a turn away from the market forces trumped up for decades by policy wonks in both countries.



File photo: Prime Minister Narendra Modi with US President Donald Trump in Ahmedabad in February 2020. Photo: White House/Flickr/Public domain.

The United States (US) and India have taken their first official step towards a formal bilateral trade deal. Their Joint Statement lays the ground rules for how tariffs (import taxes) might be changed, along with which topics both countries agree to negotiate, and how future talks will be organised. The joint statement signals a reconfiguration of the US-India economic relationship. In the past, India engaged with the US on a trade surplus footing.

Now, trade between the two countries will not just depend on **import taxes at the border**. Instead, it will be shaped by how much they trade (volumes), how government contracts are awarded (procurement pathways), regulatory standards that must be followed and which industries will get access to each other's markets.

In the conventional approach to trade liberalisation, the state defines the perimeter and markets allocate within it, i.e., the government sets the basic rules by lowering import

duties and opening markets, but then mostly steps back. Relative prices are allowed to guide resource allocation. Export performance reflects competitiveness. Import volumes adjust to domestic demand, exchange rate movements and global price shifts. Flexibility remains intrinsic to the system. In other words, market forces take over.

The framework announced in the Joint Statement departs from that logic.

Instead of simply lowering tariffs and letting prices and demand decide what happens, the agreement (Joint Statement) lays out specific, negotiated commitments. These include when and how tariffs will be reduced, explicit targets for how much India agrees to purchase from the US, and talks about aligning regulation between the two countries.

Because of this, the relevant question is not whether trade between India and the US will expand, but whether India is moving away from a system where trade is guided mainly by prices and market forces, towards one where the government makes binding international commitments that curtail its freedom to change economic policy in the future.

Tariff structure and value capture

India has agreed to **eliminate or substantially** reduce tariffs on all US industrial goods and a broad spectrum of agricultural products. The liberalisation is immediate and extensive.

[Also read: India to Eliminate Tariffs on Industrial and 'Vast Array' of Agricultural Goods: Jamieson Greer](#)

The US, by contrast, applies a reciprocal **tariff rate of 18%** on Indian exports such as of textile, leather, footwear and selected machinery categories. However, the US is not promising to remove these tariffs now – it says that will depend on future negotiations. Instead of a full exemption under Section 232 of the US Trade Expansion Act, 1962 – which allows Washington to impose tariffs or quotas on imports deemed to “threaten national security” – India has accepted a tariff rate quota arrangement in areas such as auto components, beyond which higher duties resume. In other words, up to a fix limit (the quota), imports will face lower tariffs, beyond which the duties will be much higher.

The asymmetry is therefore not rhetorical but structural. Indian concessions are front-loaded and comprehensive; US concessions remain conditional and, in some sectors, quantitatively capped.

Therefore, the terms of trade are skewed against India. Capital-intensive industrial imports can enter the Indian market duty-free, while labour-intensive exports continue to face price wedges and quantitative ceilings. The tilt favours goods with higher embedded technological rents – meaning, high-tech goods, which make more money for the US.

Trade gains depend not only on volumes but on relative prices and who captures the profits across production chains. When finished machinery, aircraft and advanced components enter India without tariff friction (duty-free) while exports remain limited, the distribution of value or economic gains skew toward the economy that controls intellectual property and high-margin segments – the US.

[Also read: Us or US? Who Stands to Benefit From the India-US Trade Deal](#)

Over time, such asymmetry influences domestic capital allocation. Investment gravitates toward assembly, integration and downstream processing within import-intensive supply chains rather than toward upstream technological capability. How India's industries grow isn't just about comparative advantage, but is shaped by the order and limits set in trade deals. The developmental logic subtly shifts from calibrated industrial deepening to externally conditioned competitiveness.

Quantity commitments and external rigidity

The commitment to purchase **USD 500 billion** of US energy products, aircraft and technology goods over five years marks a more profound structural departure.

In price-responsive systems, import volumes adjust to growth cycles and price changes. Economic slowdown compresses imports – commodity price spikes alter sourcing patterns. Being able to adjust trade and financial flows (the current account) helps the economy absorb shocks and stay stable.

A fixed multi-year purchase commitment **reduces that flexibility**. Imports become anchored to negotiated volumes – rather than natural demand conditions within the economy.

India's annual imports from the US currently stand at **over USD 45 billion**. Achieving a cumulative USD 500 billion over five years implies annual imports approaching USD 100 billion. Such scaling alters the balance of payments profile in material ways.

This rigidity becomes consequential when viewed alongside capital flow dynamics. (Net foreign direct investment inflows declined sharply in the previous fiscal year.)

When long-term capital buffers weaken, the ability of the current account to adjust becomes critical. It allows economies to manage shocks without excessively using up foreign reserves or taking on extra foreign debt.

Pre-committed import volumes narrow that adjustment margin. If export growth or capital (investment) inflows fail to expand proportionately, paying for these guaranteed imports means using up reserves or increasing external liabilities.

Over time, this constrains monetary and exchange rate policy space. Trade policy ceases to function as a counter-cyclical instrument and instead becomes a rigid requirement.

In this configuration, trade shifts from market-mediated responsiveness toward state-anchored quantity commitments.

Trade diversion and value chains

Economic theory distinguishes between trade creation and trade diversion. The energy clause – the requirement that India buys certain amounts of US energy – illustrates the distinction with clarity. If mandated purchases displace lower-cost suppliers, the economy internalises a higher input cost structure, whose effect ripples across sectors. Energy pricing permeates transportation, manufacturing margins and consumer inflation, for instance.

Aviation procurement commitments similarly reduce leverage vis-à-vis alternative suppliers. Put simply, concentrated sourcing diminishes bargaining power.

In **agriculture**, access for dried distillers' grains, sorghum for animal feed, soybean oil, tree nuts and horticultural products will reconfigure domestic value chains. Even if some finished agricultural products still have protections or tariffs, the raw materials (key upstream inputs) or intermediate goods are opened to large-scale subsidised producers. Livestock farmers will rely on imported feed, while farmers growing oilseeds and fruit or vegetables will face intensified competitive pressures.

The shift is subtle but important, as India will remain concentrated in labour-intensive low-profit stages of agricultural production, while the upstream higher-margin input segments come from abroad. Over time, this reduces rural incomes, makes farming less viable and weakens the resilience of the sector.

In manufacturing, binding industrial tariffs at **near-zero levels** constrains the calibrated use of protection that late industrialisers such as India have historically relied on to protect industries. If India cannot rely on tariffs to protect or favour its industries, its industrial upgrades will have to come from better productivity and infrastructure.

Once these trade rules are locked in, it's very hard for any country to change them or regain the ability to use tariffs and trade policy freely.

Regulatory sovereignty and digital architecture

The agreement extends beyond goods trade into regulatory domains. India has committed to address barriers affecting US medical devices, ease licensing constraints on information

and communication technology goods, and determine **within six months** whether US-developed or international standards are acceptable for American exports.

Standards are not merely technical specifications; they encode institutional authority. When external standards become benchmarks for domestic approval, the locus of validation shifts outward.

In **healthcare**, again, commitments intersect with India's price control regime governing devices such as cardiac stents and knee implants. Any recalibration driven by trade obligations has distributional implications in a system where out-of-pocket health expenditure remains significant.

In the digital sphere, commitments to address discriminatory trade practices align with fiscal incentives in the Union Budget, including tax concessions for data centres. Simultaneously, expanded **imports of graphics** processing units and technology infrastructure equipment deepen reliance on external hardware ecosystems.

Ownership of intellectual property, core hardware and standards-setting capacity remains external, while domestic participation concentrates in infrastructure provision and service integration. This configuration influences long-term technological bargaining power and digital sovereignty.

Conditional policy space

Fixed tariffs, quotas, mandated purchases, and aligned regulations are reshaping India's trade management. Trade guided by agreements rather than market forces might boost strategic standing and investment confidence, but it limits domestic policy flexibility. India's autonomy is walled in by the agreement to commitments; how much flexibility remains will become clearer as the agreement takes full effect.

Deepanshu Mohan is Professor of Economics and Dean, O.P. Jindal Global University. He is Director for Centre for New Economics Studies (CNES) and currently Visiting Professor, London School of Economics and an Academic Research Fellow at University of Oxford. Ankur Singh is a Research Assistant with CNES and is studying economics at Jindal School of Government and Public Policy.